

## THINKING OF SELLING?

SHORT VIDEO - FEBRUARY 2004

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**HERMAN:** Hello, and welcome to this brief presentation on selling a home that is financed with a VA guaranteed loan. My name is Herman Cohen, Training Coordinator at VA Central Office in Washington, D.C. With me is Sidney Ohlhausen, Senior Loan Specialist at the Houston VA Regional Loan Center.

This program is designed for veterans who used their VA entitlement to purchase or refinance their present home and who are now considering selling that home. Your VA loan gives you certain advantages in the real estate market. There are also certain responsibilities. When we are done with this presentation, you will have a good understanding of the following three important subjects:

**(PP 1)** The two different ways of selling your home, the advantages and disadvantages of each method, and, the procedures to follow for each method.

Sid, why don't you start us off?

**SID:** Thanks, Herman. First, let's discuss the two basic ways a home is sold:

One way to sell your home is to have your purchaser **(PP 2)** take out a new loan that pays off your existing loan. The other way is to have your purchaser assume your loan and take up the payments. A home that is secured by a VA guaranteed loan can be sold either way. But before listing your home for sale and making any decisions on which way is best in your situation, you should understand the advantages and disadvantages of each method.

First, let's cover the advantages of selling on a new loan.

**(PP3)** First, the existing loan is paid in full. You don't have to ever worry about someone in the future falling behind on the loan and the consequences coming back to haunt you. Your slate is completely clean on that loan. Secondly, you are eligible to apply for a full restoration of your VA entitlement for another home purchase, either immediately, or at a time in the indefinite future. Finally, and this an advantage of your VA loan - there is no prepayment penalty. That is, VA does not permit your lender to charge you for paying your loan off early. This can be a problem for sellers whose homes have conventional loans. Overall, a new loan is probably the best way to sell your home if possible. However, there are some disadvantages to this method.

( **PP4**) First the property must be appraised. Your purchaser's lender will require a current value determination to determine how much of a loan it will make. The appraisal may come in at a value less than your sales price. This may cause you to have to reduce that price. Next, the closing costs tend to be greater on a new loan than on an assumption sale. In addition to the cost of the appraisal, the new lender may require discount points, title insurance, a new survey and other costs. Next, repair requirements to meet the standards of a new loan may be required. And finally, there are more processing requirements for a new loan than for an assumption sale.

**Herman:** OK, so let's suppose, the veteran doesn't want to go with a new loan. How about the assumption sale?

**SID:** One of the advantages of your VA loan is that it is assumable. That means that your purchaser can pay you for any equity you may have on your loan and take up your mortgage payments.

The advantages of an assumption sale are as follows: (**PP5**) First, no appraisal is required. That means you may be able to obtain a higher price for your property. Of course, your buyer may want to obtain an appraisal. However, that would be the buyer's option on a case by case basis. On an assumption sale, the closing costs are usually lower. There are never any discount points to pay, and there are usually fewer other expenses. There would be no specific repair requirements, other than those that your purchaser negotiates. Also, an assumption sale usually requires less overall processing and takes less overall time than a sale on a new loan.

But there are disadvantages.

(**PP6**) The first and most important disadvantage is that your entitlement cannot be restored for a new VA loan until your assumer pays off your existing loan in full. Now there is one exception to that rule: if your assumer is a veteran who meets certain requirements, you may be able to obtain a substitution of entitlement. We will discuss that more a little later. The second disadvantage of the assumption sale is that your existing loan remains outstanding until your assumer pays that loan in full. That could take many years.

**Herman:** Why would that be a disadvantage, Sid? If someone assumes the veteran's loan, isn't the veteran relieved of all legal responsibility?

**Sid:** Very good question, and there isn't a simple answer. One of the considerations is when the loan was originated.

(**PP7**) On VA guaranteed loans originated after March, 1988, VA requires that in most cases, the assumer be approved. That means evaluating the credit and income of the assumer to verify ability to maintain the mortgage payments. Once the assumer is approved and the sale is closed, the veteran is released from liability on that loan.

**Herman:** Being released from liability sounds pretty simple to me. The veteran is no longer responsible, right?

**Sid:** Strictly speaking, yes. A release from liability means that the veteran is no longer legally responsible for the loan. Even if the assumer defaults on the loan and the government loses money as a result of foreclosure, the veteran is not legally required to pay anything.

**Herman:** So what's the downside for the veteran?

**Sid:** Remember the point we made earlier. This bears repeating, because it is one of the most misunderstood aspects of the VA loan program. As long as the loan remains outstanding, regardless of the release of liability, the veteran's entitlement cannot be restored for another VA loan, with the one exception we mentioned earlier about the substitution of entitlement. In addition, if the assumer allows the loan to go to foreclosure and the government suffers a loss, the entitlement can still not be restored unless the government is reimbursed for that loss.

**Herman:** But if it's not the veteran's fault that the loan went to foreclosure, why should it tie up the veteran's entitlement?

**Sid:** This is a requirement of the law. As long as there is a loss to the government resulting from use of VA entitlement, that entitlement cannot be reused until the government is made whole for that loss. That is true regardless of who was at fault in creation of that loss.

**Herman:** But you mentioned there is one exception to that with a substitution of entitlement, right?

**Sid:** Yes. If you sell on assumption (**PP 8**) to an eligible veteran who is going to occupy the property, who has enough entitlement to substitute for yours, and who can meet the credit and income requirements for the loan, you can get your entitlement restored.

**Herman:** So for a substitution of entitlement, it's not enough just to sell to another veteran?

**Sid:** Right. The veteran must meet all those requirements we mentioned and you as the seller must apply for and receive a substitution of entitlement before your entitlement can be restored.

**Herman:** Once the entitlement is substituted, the original veteran's entitlement is freed up for another home purchase, even though the loan is still outstanding?

**Sid:** Right. In that one situation, a restoration would be possible even though the present loan is still outstanding.

**Herman:** You mentioned earlier that approval of an assumption sale was required “in most cases.” What are the cases when the veteran can sell without getting the assumption approved?

**(PP 9)** Certain transfers to relatives and transfers related to the death of the veteran are exempted from the approval requirement. In addition, transfers due to divorce and certain transfers to a living trust do not require approval. If you are in one of those situations, you may want to discuss it with your lender or a local VA office before proceeding.

In addition, VA guaranteed loans that were originated prior to March, 1988 do not require assumption approval. However, in those cases, we recommend the veteran still obtain that approval. Otherwise, the veteran would not be released from liability on the loan.

**Herman:** Now we have covered a lot of material. Can we stop and review for a moment?

**Sid:** Sure. First, there are two ways to sell your home:

**(PP 10)** On a new loan, or on assumption.

A new loan has the advantage of completely wiping out the old loan, but it can be slower and more expensive to process. An assumption sale may be quicker and cheaper, but it leaves the old loan outstanding. This might prevent you from obtaining another VA loan, unless you obtain a substitution of entitlement.

**Herman:** OK, so we’ve covered the two ways of selling and the advantages and disadvantages of each. How does the veteran proceed with the actual sale of the home?

**Sid:** The first step is to put the house up for sale. This will ordinarily be done through a real estate agent. You will need to decide on an asking price of the home. You can still leave your options open for sale on a new loan or assumption at the time you list the property. But remember, if you plan to reuse your VA entitlement after selling your present home, you will need to sell either on a new loan or on assumption only to an eligible veteran who will qualify for a substitution of entitlement and you will need to make that clear on your listing agreement with the broker. If you sell on assumption without getting a substitution of entitlement, you will not be able to reuse your entitlement for a new VA loan until that assumer pays the loan in full, which may take many more years.

**Herman:** So let’s suppose the vet has a purchaser who wants to take out a new loan. What happens after the purchaser signs the contract?

**Sid:** The purchaser will have to go to a lender to apply for a loan. The purchaser may choose their own lender. The lender will take the application and order an appraisal. If the

buyer is approved and the property appraises for enough, the lender will proceed to close the loan. The purchaser's lender will send the veteran's lender the funds necessary to pay off the VA loan. The veteran's lender will then advise VA that the veteran's loan has been paid in full.

**Herman:** So when the veteran's lender informs VA that the veteran's loan is paid in full, does that automatically restore the veteran's entitlement for a new loan?

**Sid:** Not automatically. The veteran needs to send an application form to VA to apply for an updated Certificate of Eligibility.

**CG 1:** VA Form 26-1880

That's the VA Form 26-1880 and you can get a copy from your local VA office...

**CG 2:** 1-800-827-1000

...or you can call our toll free number, 1-800-827-1000 to have a copy mailed to you. If you are sending in the application shortly after closing the sale, it's a good idea to include proof your VA loan has been paid in full, since lenders don't always report this right away to VA.

**Herman:** Suppose the purchaser is buying on assumption. What's the next step after signing the contract?

**Sid:** If the loan was originated after March, 1988, the assumer must go to the veteran's lender and apply for assumption approval. In this case, the purchaser doesn't have the choice of a lender. They must go to the lender that the veteran makes mortgage payments to. The lender takes the assumer's application, just like with a new loan. But no appraisal is required. The lender charges a fee of up to \$300 plus the cost of a credit report. In addition, there is a VA funding fee of  $\frac{1}{2}$  of one percent unless the veteran is exempt. As soon as the assumer is approved, the loan can close and the veteran is released from liability on the loan.

**Herman:** The veteran is released from liability, but does not get entitlement back for another loan, right?

**Sid:** Right, unless the assumer is a veteran who will occupy the property and who qualifies for a substitution of entitlement. In that case, after receiving approval; from the lender, the veteran assumer would have to apply directly to VA for the substitution.

**Herman:** Is this something the real estate sales broker handles?

**Sid:** The broker may offer assistance. But if you are trying to get a substitution of entitlement, do not leave it up exclusively to the broker. It is the veteran's responsibility to make sure the substitution is approved by VA. If VA does approve the substitution, we will

send the veteran an updated Certificate of Eligibility showing restoration of entitlement for use on another loan.

**Herman:** Again, we have covered a lot of material. Sid can we stop and review the sales process?

**Sid:** Sure. **(PP 11)** First, the property is listed for sale. Then the buyer and seller agree to a price and sign a contract. The buyer then goes to a lender. If the buyer is approved, the loan closes. Finally, if the sale was on a new loan or to an eligible veteran with a Substitution of Entitlement, the veteran applies for restoration of entitlement.

**Herman:** Thanks, Sid. Now let's quickly round up a couple of loose ends. You said that a veteran who sells on assumption and does not get a substitution of entitlement cannot use that entitlement again for another home purchase. Suppose the veteran didn't use all his entitlement on the original loan and has some entitlement left over?.

**Sid:** In most cases, a veteran uses all or most available entitlement when purchasing a home on a VA guaranteed loan, and won't have enough left over for another purchase. Occasionally, it's possible. The price of the second property would have to be fairly low, or the veteran would have to be willing to make a down payment. The specifics of a case would have to be discussed with a lender.

**Herman:** I have one more question. I've heard of something called a "compromise" sale that doesn't fall exactly into any of the categories you mentioned. Could you explain what that is?

**Sid.** Sure. A compromise sale is an option that is sometimes available on a VA guaranteed loan when you need to sell your property but the value is less than the balance of the loan. In these cases, VA agrees to accept less than the full balance of the loan so the veteran can dispose of the property and avoid the expenses of foreclosure. This program can be a real help in getting a veteran out of a difficult situation, but there is one significant disadvantage.

**Herman:** Let me guess: the veteran's entitlement can't be restored for another home purchase.

**Sid:** That's right. A compromise sale causes the government to suffer a loss since VA agrees to accept less than the full balance of the loan. Remember that law we referred to earlier that says if the government loses money as a result of extension of the home loan benefit, that benefit cannot be restored the government is made whole for the loss.

**Herman:** So, a veteran who wants to get a restoration of entitlement after a compromise sale, would have to reimburse the government for that loss?

**Sid:** Yes.

**Herman:** OK. Thanks, Sid. We have tried to give you in this program a brief overview of what's involved in selling your home if it has a VA guaranteed loan. Let's go back to our original objectives and make sure we've covered everything.

**(PP 12)** First, we described the two ways of selling a home: on a new loan, or on an assumption. Then we discussed the advantages and disadvantages of each method. Remember, if you sell you home on assumption, you may have a problem later in getting another VA loan. And finally, we went over the procedures you and your purchaser have to follow with each method.

We hope you have found this presentation helpful. You can find most of what we have covered and a lot more in VA Pamphlet 26-5, "Pointers for the Veteran Homeowner"

**SS 1:** VA Pamphlet 26-5.

available at your local VA office...

**CG 2:** 1-800-827-1000.

...or you can call toll free, 1-800-827-1000 to have a copy mailed to you. Again, this is Herman Cohen. For myself and for Sid Ohlhausen, thank you for watching.

## **POWER POINT SLIDES**

### **PP1: 1: Objectives**

1. 1. Two ways of selling a home.
2. 2. The advantages and disadvantages of each method, and
3. 3. The procedures to follow with each method.

### **PP 2: Ways to sell a home**

New Loan  
Assumption

**PP3: New Loan Sale: Advantages**

Existing Loan is paid in full  
Eligibility for VA restoration  
No prepayment penalty

**PP4: New Home Sale: Disadvantages**

Property must be appraised  
Generally more closing costs  
Stricter repair requirements  
Possible longer processing time

**PP5: Assumption Advantages**

No appraisal required  
Usually lower closing costs  
Flexible repair requirements  
Usually faster

**PP6: Assumption Disadvantages**

No VA restoration (except with Substitution)  
Loan remains outstanding

**PP7: Date of Origination**

Since March, 1988:  
Approval & Release

**PP 8: Substitution of Entitlement**

1. 1. Eligible veteran
2. 2. Occupy property
3. 3. Has enough entitlement
4. 4. Meets income & credit requirements

**PP 9: Assumption Approval Not Required**

1. 1. Relatives
2. 2. Death
3. 3. Divorce



4. 4. Living trust
5. 5. Loan originated before March, 1988.

**PP 10: Ways to sell**

New loan  
Assumption

**PP 11: Selling the home**

1. 1. List property for sale
2. 2. Buyer and seller sign contract
3. 3. Buyer goes to lender
4. 4. Loan closes
5. 5. Vet applies for restoration (new loan/SOE)

**PP 12: Objectives**

1. 1. Two ways of selling a home.
2. 2. The advantages and disadvantages of each method, and
3. 3. The procedures to follow with each method.